

Title: Competition for an exclusivity of a superior input and implications for quality

Abstract:

We analyze the implications of exclusive dealing of a “superior input” (reducing cost of quality) on quality and prices. Two firms first compete for the superior input by offering a menu of exclusive dealing and non-exclusive dealing tariffs. They then choose their quality and price. We show that the exclusive dealing is a unique equilibrium when the input changes the competitiveness of either firm (affecting its equilibrium quality). Otherwise, there exists also a non-exclusive equilibrium. Using the Hotelling model we find that the quality pass-through of the firm with exclusivity could be above one and exclusive dealing harms consumers, but might increase welfare. When the firms are asymmetric in their demand potential, consumer harm due to exclusivity is lower and exclusivity more likely to increase total welfare. Banning exclusive dealing of only the big firm might lower total welfare and consumer surplus compared to the laissez-faire regime. We provide implications for digital platforms.